E-015/GR-94-001 ORDER SETTING INTERIM RATES

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Marshall Johnson	Commissioner
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner

In the Matter of the Application of Minnesota Power for Authority to Change Its Schedule of Rates for Retail Electric Service in the State of Minnesota	ISSUE DATE: February 25, 1994 DOCKET NO. E-015/GR-94-001 ORDER SETTING INTERIM RATES

PROCEDURAL HISTORY

On January 3, 1994, Minnesota Power filed a petition seeking a general rate increase of $34,348,800, or approximately 11.78%. Along with the rate increase petition, the Company filed a proposed interim rate schedule, to be effective March 1, 1994. The interim rate request, if allowed, would increase present revenues by $20,133,135, or 7.09%.

On February 7, 1994, the Commission issued its NOTICE AND ORDER FOR HEARING, in which the Commission referred the rate case to the Office of Administrative Hearings for contested case proceedings. On the same day, the Commission also issued its ORDER ACCEPTING FILING AND SUSPENDING RATES. Under Minn. Stat. § 216B.16, subd. 3, if rates are suspended the Commission must set an interim rate schedule within 60 days of the Company's initial petition.

This matter came before the Commission for consideration on February 17, 1994.

FINDINGS AND CONCLUSIONS

I. The Interim Rate Statute

Minn. Stat. § 216B.16, subd. 3 states in part as follows:

> Unless the commission finds that exigent circumstances exist, the interim rate schedule shall be calculated using the proposed test year cost of capital, rate base, and expenses, except that it shall include: (1) a rate of return on common equity for the utility equal to that authorized by the commission in the utility's most recent rate proceeding; (2) rate base or expense items the same in nature and kind as those allowed by a currently effective order of the commission in the utility's most recent rate proceeding; and (3) no change in the existing rate design.

II. The Company's Proposal

Minnesota Power proposed an interim rate increase of $20,133,135 based on the following revenue summary:

Rate Base	$483,303,236
Rate of Return	9.31%
Required Operating Income	44,986,583
Net Operating Income	33,182,526
Income Deficiency	11,804,057
Revenue Conversion Factor	1.705611
Revenue Deficiency	20,133,135

III. The Company's Most Recent Rate Proceeding

Minnesota Power's most recent rate proceeding was Docket No. E-015/GR-87-223, In the Matter of the Application of Minnesota Power and Light Company, Duluth, Minnesota, for Authority to Change Retail Rates for Electric Utility Service in Minnesota (the 1987 rate case). The Commission issued its FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER in that proceeding on March 1, 1988.

IV. Financial Issues

Following are some of the most important financial issues.

A. Conservation

Minnesota Power included approximately $7.5 million in conservation costs for interim and final rates. The expense was calculated using a 2.64% conservation program adjustment in the Company's resource recovery charge, as authorized in Docket No. E-015/M-93-996.[1]

In the 1987 rate case, the Commission allowed the Company recovery of its conservation expenses. Although the recovery rate was calculated in a different manner in the current rate case, the expenses are the same in nature and kind as those in the Company's most recent rate proceeding. The Commission will allow Minnesota Power its proposed conservation expenses in interim rates.

B. Economic Development

Minnesota Power proposed recovery of 100% of its economic development costs of $1,026,514 in final rates and 50% of these

[1] In the Matter of the Petition of Minnesota Power for Approval of an Annual Recovery Mechanism for Conservation Related Costs and Expenses and for Variance of Fuel Clause Adjustment.

costs in interim rates. The Company noted, however, that it had erred by failing to reduce the expense by 50% in its interim rates calculations. As a result, the Company's proposed economic development costs exceed 50% by $90,763.

In the 1987 rate case, the Commission did not allow costs which were in the nature of economic development. Since that rate case, however, Minn. Stat. § 216B.16, subd. 13 was passed. That statutory subdivision permits the Commission to allow utilities recovery of their expenses for economic and community development. The need to address the statutory change constitutes exigent circumstances which allow recovery in interim rates in this case. The Commission will allow Minnesota Power its proposed 50% recovery of costs for economic development in interim rates.

The Commission will not require an adjustment to correct the $90,763 error. Absent other adjustments, recalculating the Company's financial data to adjust for this relatively small amount in interim rates would not be cost-beneficial.

C. FAS 106

In its September 22, 1992 generic Order in the Financial Accounting Standards (FAS) 106 docket[2], the Commission allowed deferral of FAS 106 expenses and precluded recovery in interim rates.

The Company has properly excluded FAS 106 costs from its interim rate request. It will be seeking recovery of these costs in the final case.

D. Unbilled Revenues

The Company used the unbilled method in calculating test year revenues. In prior proceedings, including the 1987 rate case, the Company applied the billed method to calculate revenues. The change in accounting method results in an increase in test year revenues of $163,000. The unbilled method is used in the Company's interim rates calculation.

The Commission finds that the change in accounting methods does not render expenses unlike in nature or kind for interim rates purposes.

E. Leveraged ESOP Interest

Minnesota Power proposed recovery of $37,680 in interest expenses associated with the savings and tax benefits of its leveraged employee stock ownership plan (ESOP). The ESOP was first offered in 1989.

[2] In the Matter of the Accounting and Ratemaking Effects of the Statement of Financial Accounting Standards No. 106, Docket No. U-999/CI-92-96.

In the 1987 rate case the Company recovered costs of its supplemental benefits to employees. Because the ESOP was created to replace these benefits, ESOP costs are the same in nature and kind as those allowed in the Company's prior rate case. Although interest is usually not separately recovered as a rate case expense, in this case it is part of the overall tax savings/interest expense formula and should be included for interim rates. The Commission will allow ESOP interest costs in interim rates.

F. Cash Payments on Large Power Contract Extensions

In recent years, Minnesota Power has made cash payments to certain individual taconite companies as part of the renegotiation of sales contracts with those companies. Minnesota Power proposed including an amortized portion of the payments in expenses and including the unamortized balance in rate base.

Although cash payments for large power contract renegotiations have not been previously included in rate case Orders, they are actually a cost of these longstanding contracts. As such, they are the same in nature and kind as previous contract costs approved in the last rate case Order.

G. Interest on Taconite Weekly Billing

In the 1987 rate case, the Commission ordered Minnesota Power to develop a tariff providing for weekly billing for taconites. The resulting tariff requires the Company to provide a credit to the taconites for the time value of money. The credit is booked below the line as an interest expense. In this rate case Minnesota Power included the interest as a proposed expense for both final and interim rates.

Although interest is not usually a separate income statement expense for ratemaking purposes, here the interest is part of a tariffed cost required in the Company's last rate case. The Commission will allow recovery of these expenses in interim rates.

H. FAS 112

Financial Accounting Standard 112 requires companies to report certain post-employment benefits on the accrual basis instead of the cash basis. In contrast with FAS 106, which is concerned with post-employment medical benefits, FAS 112 focuses on workers compensation claims and long-term disability claims.

Minnesota Power proposed a one-time accrual expense of $1,504,283 for FAS 112 for both interim and final rates.

Although these expenses are now considered on the accrual basis rather than the cash basis, they are still the same in nature and kind as those expenses found in the Company's last general rate case. The Commission will allow the inclusion of FAS 112 costs for interim rates.

I. Incentive Compensation

Minnesota Power proposed recovery of approximately $2.1 million for incentive compensation in interim and final rates.

In the 1987 rate case Minnesota Power was allowed recovery of approximately $800,000 in costs for management compensation beyond salary. Although the presently proposed compensation plan contains different features and is greatly expanded from the 1987 plan, it is the same in nature and kind and should be allowed in interim rates.

V. Rate of Return

Minn. Stat. § 216B.16, subd. 2 provides that, absent exigent circumstances, interim rates shall be calculated using the proposed test year cost of capital and a rate of return (ROE) on common equity equal to that authorized in the company's last rate case.

Minnesota Power's interim rates filing included an ROE of 11.56%, which is the level approved in the 1987 rate case. The Company's proposed interim rate schedule was calculated using the proposed test year cost of capital.

The Commission approves the Company's proposed interim rate of return.

VI. Interim Rate Design

Minnesota Power proposed an interim rate increase collected from all classes of customers through a surcharge of 7.09% (the increase requested in interim rates) on each retail rate schedule.

Because the proposed interim rate design is not a change from existing rate design, it complies with Minn. Stat. § 216B.16, subd. 3. The Commission approves the Company's rate design for the purpose of interim rates.

ORDER

1. The Commission authorizes Minnesota Power to collect $20,133,135 in additional revenues, or 7.09% of revenues under current rates. The interim rate schedule will be effective for service rendered on or after March 1, 1994.

2. Within seven days of the date of this Order, the Company shall file with the Commission and the Department of Public Service interim tariff sheets and supporting documentation reflecting the decisions herein. The Company's filing shall include a proposed notice to customers, approved by the Executive Secretary of the Commission, regarding the rate change under the interim rate schedule.

3. The Company shall keep such records of sales and collections under interim rates as will be necessary to compute a potential refund. Any refund shall be made within 120 days of the effective date of the Commission's final Order in a manner approved by the Commission.

4. The Company shall include with each customer's first bill under the interim rate schedule a notice of the rate change, approved by the Executive Secretary. Upon completion of this task, the Company shall certify this fact to the Commission.

5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)